EXHIBIT A

IN THE COMMONWEALTH OF PENNSYLVANIA

\- - -

IN RE: Senior Health	: NO. 1 SHP 2020
Insurance Company of	:
Pennsylvania in	:
Rehabilitation	:

\- - -

Monday, May 17, 2021

\- - -

Proceeding in the above-captioned matter held before THE HONORABLE MARY HANNAH LEAVITT, at the Commonwealth Court of Pennsylvania, 601 Commonwealth Avenue, Harrisburg, Pa., commencing at 10:00 a.m., on the above date, before Karen A. Nickel, Certified Realtime Reporter and Notary Public in and for the Commonwealth of Pennsylvania.

\- - -

MAGNA LEGAL SERVICES

(866) 624-6221

www.MagnaLS.com

So you can see that we are now at the point at which the volume of claims is outpacing the premium that the company is collecting, and what's more troublesome for us is that of the total premium that SHIP is expected to collect from the expiration of the policies in force, which is about $7.4 billion, we have already collected 7.1 billion. We only have about $300 million in premium we expect to collect.

On the other hand, we expect total claims to be paid during that period of, approximately, $11 billion, of which we have only paid about $7.7 billion so far. So we expect to be paying another $3 billion in claims or so in the absence of a plan, but only collecting $300 million in premium.

This is not atypical. Long-term care insurers expect to collect a lot of premium upfront, invest that money, put it aside, and then when the curve starts rising on the claim side -- because policyholders might be applying for benefits, and clearly you have a big part of money set aside from previously collected and invested premium.

Unfortunately, when you stop selling new business, as SHIP did 18 years ago, the premium curve starts flattening and the claim curve starts rising. And in the case of SHIP, the investment income has been much lower than anticipated, for reasons I will explain a little bit later on.

But as I said, right now the picture is a little bit grim because we are going to be paying ten times as much in claims as we are collecting in premium.

Q. What portion of SHIP's policyholders for LTC are on claim?

A. I think we are about 13 percent right now, which is a little bit above the industry average. But as you can see on Slide 21, which is also part of Exhibit 33, that curve is also expected to continue, so that by the time the block runs off, we are probably going to be about one in three policyholders on claim.

Q. Mr. Cantilo, I'm going to turn to the current financial condition of SHIP. Can you describe it for me, please?

A. Sure. If we can put up Slide 20 --

I'm sorry, 23. That table, which also appears on Exhibits 31 and Exhibit 55, which are two versions of the plan, summarizes the financial history of SHIP for the last 11 years, and you can see that back in 2009, shortly after it was spun off, it had reportedly serviced 193 million, run out before 2019 with a deficit and for 2020 that has gone up about 300 million to a deficit of 1.2 billion. It has been a steady decline, as you can see on this table, and I think the larger drop from 2014 to 2015, maybe even the one from 2013 to 2014, led the company to become a lot more concerned.

They started that special examination for 2016. By the time those numbers came in in 2017, you can see the company had halved its surplus from 55 million to 28 million.

And then that was cut in half again for the 2017 annual statement, which is actually filed in March of 2018, about the time I was involved. So it's been a little bit of a grim picture.

Slide 23 -- I'm sorry, 24 has more updated information. That actually has the

detailed numbers from last year, and you can see that now, we are at a little bit under $1.4 billion in assets with about $2.6 billion in liabilities, creating the $1.2 billion deficit that I described earlier.

That deficit has probably stabilized a little bit. It's even possible it's a little bit lower by the end of 2021 or projected to be a little bit lower by the end of 2021 than it is now, but either way, it's not going to be material to the plan.

On the next slide, Slide 25, I actually have a graph that is part of Exhibit 36, or proposed Exhibit 36, I should say, that tracks the relationship between assets and liabilities over the same 11-year period, and you can see how that relationship has grown, the gap has grown between the two.

And on the next slide, 26, you can see how the company's capital and surplus has dropped.

Now, these are reported numbers, and I emphasize that, Your Honor, because I don't want the Court to misinterpret my testimony as saying that we believe that the reported

surplus of 2009 or even 2016 is accurate. That's just a number the company was reporting.
It wasn't until 2017 that we have material influence in the way in which the company was reporting its financial condition. And by 2018, as I will explain in a few minutes, they have made some adjustments we requested, and that's why you saw the company go from a $12 million surplus to a half a billion dollar deficit in that one-year period.
Q. Mr. Cantilo, let's dig into the causes of the insolvency that SHIP faces. Can you summarize how we got here?
A. There are a number of factors. I think the most important factor in terms of volume is what we believe to be erroneous actuarial assumptions made when the policies were first issued and as reserves were calculated in the ensuing years.
The key actuarial assumptions to which I am referring are morbidity, the rate at which people become ill and require care, morbidity improvement, the rate at which they become healthier so they need less care, rate of mortality, how many people died in a given

year, and the rate of which policies terminate for any of a number of reasons.
So we suspect and have confirmed that the company was operating on understated morbidity assumptions, that is, they underestimated how many people would become ill and qualify for benefits. They overestimated how quickly people would become healthier and stop needing as much care. That's what the industry calls morbidity improvement. They overstated mortality which, as I say, ironically, mortality rates help the company because they remove insureds from the pool of people who can get benefits. They assume more people would die than actually died. And then they overstated or overestimated a number of policies that would lapse because of death or non-payment of premium.
Apart from the problems with the actuarial assumptions, of which I'm sure we will return, the company has had a pretty poor history with its investments. The problems are primarily in two categories. The broader capital markets have seen dramatic drops in yields from the time these policies were first

sold in the '70s and '80s to today, and, in addition, the company has made some unfortunate investment decisions that have also removed some capital from the picture.
There was a concern that the company's operating costs were also high, and we made some efforts working with management to reduce those operating costs. So although they were a factor, I would not say that those were a major factor.
And then the last big component, which, again, is common in the industry, is that when SHIP management realized that its premium rates were too low because of the understated or misstated actuarial assumptions and attempted to increase its premium rates, it received mixed responses from regulators around the company with twin bad effects of, A, not getting enough additional rate to help with the problems, and, B, creating a hopscotch of very different rates across the country so that two policyholders of similar characteristics with similar coverage, with policies issued in different states, might be paying widely different premiums, sometimes a factor of four

or five times the premium, just because different states reacted to rate requests in a different manner.
Q. So Mr. Cantilo, let's focus on certain of these causes of deterioration, the assumption. How big a problem were the actuarial assumption errors you described?
A. We have a slide, slide 29, in which we have aggregated what we think is the impact of just the actuarial assumptions and, as you can see, we projected it through 2040, which is when we think most of the block will have run off, and as of that date, we expect that the aggregate effect of these assumptions beginning only in 2012 is about the size of our deficit, $1.2 billion. We have not gone back to project the effect of the assumption before 2012.
Q. I think the next item on your list referred to investment performance projections.
A. Right. So SHIP, like everyone else investing in the American market, has experienced lower yields from its invested assets. If you look at Table 30, that -- those two graphs which come from Exhibit 40 are the United States Treasury bond curves for the

analysis was whether we should go into liquidation or rehabilitation or come to this Court, I should say, with a liquidation or rehabilitation plan. And for reasons that I can explain in more detail later, the decision was made that rehabilitation was appropriate here.

And the key components of that were, there is enough money left at SHIP to be able to provide fundamental coverage to our remaining 40,000 policyholders, albeit not the rich coverage that a lot of those policies provide, and this is, and it sounds a little counterintuitive, but this is a major factor; we knew that a lot of policyholders had been underpaying for their policies for a long period of time, decades, and we knew that if we came to this Court requesting a liquidation order, that a likely consequence is that the guaranty associations would be triggered, then, ultimately, the taxpayers would be asked to step up and contribute hundreds of millions of dollars to pay claims under those policies.

And the question that we were debating is, is it reasonable, if a

policyholder has been paying a quarter for a dollar's worth of insurance for decades, to adopt, as the workout plan, a plan in which the taxpayers step up to pay their remaining 75 cents.

And what we concluded is that we could right size the policy, and we could create a set of options for policyholders that would enable them to get fundamental LTC coverage but pay reasonable rates like the rest of the country for that coverage and not shift all that burden to the taxpayers.

I don't mean to minimize the policy because it made every penny -- whether that's the case or not, the fact is they were mispaying for the coverage and we thought the plan could have a proper goal the right size of the policy, so that the relationship between the premium and the benefits was reasonable.

That, after all, is a fundamental requirement of rate regulation. When regulators across the country approve rates for insurance policies, the key consideration is between rates and benefits are reasonable.

We concluded, for SHIP, that was no

longer the case and we thought a rehabilitation plan could be put together that would remedy that. And we thought if we did that, it would result in reduction of liabilities and it would offset the deficit to a large degree.

I will be very candid with the Court, as we always have been, it is not likely that we will magically restore SHIP to solvency, but it is likely that the plan that we were trying to design would substantially reduce the deficit and substantially improve the inequitable rate structure for the company.

That was the goal when we sat down to put a plan together.

Q. Did you consider any other options besides the plan?

A. Of course. There were things that we had considered earlier in the case of Penn Treaty and we thought maybe they would work here.

So the first thing we looked at is selling the company, but a company with a $1 billion deficit and a losing book of business and not selling any new business does not attract a lot of buyers.

So that one didn't get very far.

We looked at a good bank/bad bank structure, which is a structure we had worked a lot on in the Penn Treaty case, but, unlike Penn Treaty that had two licensed insurers, SHIP is only one licensed insurer and for good bank and bad bank to work, you have to have a good bank and bad bank around the country and that was --

Q. Can I just ask you to pause and explain for the record what good bank/bad bank would entail?

A. So it means a lot of different things to a lot of different people, but the context in which I am using good bank/bad bank is a scheme in which you separate the bad part of the insurance business and put in a liquidation vehicle and put the good part of the insurance business in a surviving vehicle that you hopefully will restore to solvency.

Q. So now, the third item, ancillary approval of modifications, what does that mean?

A. Well, we recognize that the only way a rehabilitation plan would work is to modify the insurance policies, and we anticipated that there might be resistance, especially to premium rate increases from other states, not because we didn't think that we had the legal authority to do that, but because it is unprecedented.

The reality is that most companies that went to rehabilitation are not collecting premium, so the notion of premium increases doesn't come up in rehabilitation.

And we -- the first thing we decided is, look, everyone understands we can change the benefit, so surely if we can change the benefits, we can change the premium. So two sides of the same equation. We realized, even if that seemed logically the case, that regulators tend to feel strongly about the exercise of authority on rates, and so to avoid a fight on the issue, one of the things we considered early on is to subject the policy and rate modifications to each of the states as part of the rehabilitation plan.

But we concluded pretty early on that that approach overlooked all of the history where the company had the checkerboard experience from rate increase across the

country and it would take far too long for the plan to become effective in time to do much good. So we thought ancillary approval of the modifications just wasn't going to be an effective strategy for SHIP.

Then we thought about excluding the policies of states that didn't want this Court and Jessica Altman, the Insurance Commissioner, to modify. But that created an unfairness or inequity problem because we would have a plan that would benefit some and not others, and it wouldn't be the policyholders that get to make that choice; it would be regulators. So we thought of that option for the same reason.

We spent a lot more time on regulation and, as I said earlier, we concluded we could do a lot more good for policyholders and for the company with this plan than with a flat-out liquidation.

Q. I believe you testified earlier that a liquidation would shift a burden to the taxpayers. Can you just explain briefly how that worked?

A. Certainly. So if we were to place SHIP on a liquidation, as Penn Treaty has been,

for example, the guaranty associations and each of the states in which SHIP's policyholders reside would be triggered and required to guarantee, assume or reinsure, or cause to be guaranteed, assumed or reinsured, all of the policies in force in that state.

And the obligations of the guaranty associations would be capped at a stated dollar amount, typically $300,000, and the guaranty associations would first collect at least a portion or maybe all of SHIP's assets, and then assess other insurers around the country to pay those claims.

When they do that, the assessed insurers themselves, in turn, get to reduce their premium tax payments over, typically, a five-year period by the amount of the assessment, and they pay for failed insurers.

There are exceptions in California, for example, a set of premium tax offsets, the insurers get to surcharge on for the assessment.

But one way or another, the assessments are first borne by the insurance company and then passed on to taxpayers or

policyholders. If we put SHIP in the equation, that is who would pay 75 percent on the hypothetical underpricing.

Q. So we will return to a comparison of rehabilitation and liquidation, but first, I would like you to tell the Court how you and the others assisting the Rehabilitator in developing the plan, how did you come to the plan?

A. So we benefited from having had the experience of doing a lot of this work in Penn Treaty, so we were able to hit the ground running. Our group, including Oliver Wyman, some people from the department and from management, set out to define the broad strokes or the basic elements of the plan. As I said a little bit earlier, one of the keys was to be able to provide coverages to policyholders that the company could afford but would not be so expensive.

So we looked, for example, if we can look at Slide 55 -- I'm sorry, 59. My age is catching up with me.

This is an illustration of the things at which we were looking. This graph

Q. The exhibits that counsel just --
A. I do not.
Q. You don't. Okay. Well, with your indulgence, then, I would --
A. I have them on the screen.
Q. Do you recognize the Oliver Wyman actuarial report on the screen?
A. I do.
Q. Are you familiar with it?
A. Somewhat. I am not an actuary, but I have read it.
Q. As the special deputy liquidator, this actuarial report, would it be something you would read and --
A. Yes, sir.
Q. -- seek to understand?
A. Yes, sir.
Q. Okay. Let's go to Page 11 of this report, if we could. Can you see that on the screen, Mr. Cantilo?
A. I can.
Q. Okay. I draw your attention to the first line, there are two blocks of illustrations here, and I want to draw your attention to the first line entitled Current

Reserves in the topmost block.
Do you see that?
A. I do.
Q. So the gross premium reserve, can you explain what that is?
A. It is the projection for the total liabilities expected to arise under the policies in force in excess of the premium available to fund them.
Q. Is this a present value calculation of those obligations net of a present value of premium?
A. Yes.
Q. So present value underlies the calculation of the gross premium reserve?
A. Correct.
Q. And the next number is the funding gap, which is $1.2 billion. The uncovered reserve, what is that?
A. That is a portion of the projected liabilities that is expected to exceed the applicable guaranty association limits for those policyholders.
Q. Okay. So if we take the funding gap of $1.2 billion and subtract the $606 million

which exceeds the guaranty fund limits, does that leave you with a $600 million gap you would otherwise have to fill in order for the plan to fill and satisfy the funding gap?
A. It leaves 600 million.
Q. If the gross premium reserves reflect covered and uncovered liabilities, being the covered and uncovered liabilities of the guaranty funds, does that mean that approximately $600 million of covered benefits need to either buy the voluntary action of policyholders or through the operation of the plan have to be reduced?
A. If you are asking me in order to reduce the liabilities to fully cover liabilities, the $600 million in liabilities have to be eliminated, hypothetically, that makes sense.
Q. So the financial statements of SHIP, are they filed in accordance with statutory accounting principles?
A. They were before SHIP was placed under rehabilitation.
Q. When you filed the 2020 financials, were those prepared in accordance with

statutory accounting principles?
A. There were no 2020 financials filed.
Q. Filed. Okay. Could we draw up Exhibit RP 12. We'll be going back to this exhibit. Okay.
So when you used the word "filed," do you mean filed with the various states?
A. I interpreted your question to be asking about that, and that's the way in which I intended that response.
Q. This financial statement, was it prepared in accordance with statutory accounting principles?
A. I did not prepare that statement so I can't answer the question.
Q. Was it prepared under your supervision?
A. I requested it be prepared.
Q. Is this number critical to analysis of the financial condition of SHIP?
A. It is important.
Q. Doesn't this calculate the funding gap; isn't the funding gap dependent upon these financial statements?
A. The funding gap is not dependent on

Q. The pricing, the actuarial assumptions that underlay pricing assumed certain investment returns; correct?
A. Correct.
Q. And then there were actual investment returns, that's correct, too; right?
A. Correct.
Q. And the difference had an impact?
A. Correct.
Q. And that impact contributed to the funding gap?
A. Absolutely.
Q. Do you have a sense of whether that was material?
A. Yes, it was material.
Q. Okay. And do you have a sense of whether it was as material as the -- as the rate deficiency?
A. Because I don't have a quantity for that sum, I can't say whether it was more or less material than the underpricing, but it was definitely material.
Q. And yesterday you testified about a couple of investment decisions that had been made and the losses that SHIP endured from

those decisions.
A. Yes.
Q. I believe you estimated the range of those impacts as between 150 and $200 million; is that right?
A. It could even exceed that.
Q. And so would that also be contributing materially to the funding gap?
A. Absolutely.
Q. And so, you know, that 150 to 2 or $300 million, that number seems to correlate to the 300 or so of premium that was foregone as well through regulator action, so it's a material number that contributed to the gap; right?
A. Is your question whether it's similar or whether it's material?
Q. Was it material?
A. It was material.
Q. So $300 million of premium rate, premiums not approved, a material effect due to the drop in the capital markets and several hundred million dollars, a couple, 300, whatever, range due to investment decisions, all of that affecting materially the funding

gap?
A. Is there a question?
Q. I am asking you if you agree with that or not; is that correct?
A. Do I agree that those things affected the funding gap, yes.
Q. Materially?
A. Yes.
Q. Is it your opinion that the Rehabilitator of an insolvent life insurer has the discretion to impose the entire cost burden of the insolvency on the insurer's current policyholders and not trigger the guaranty associations?
A. Are you asking me if I think that's the law?
Q. Is that your opinion, yes.
A. My opinion is that the discretion of Rehabilitators and rehabilitation Courts can include that, yes.
Q. So if the policy -- so the policyholders of SHIP need to address through these options or -- let me try it a different way.
The five options made available

under Phase One of the plan, are they intended to reduce the funding gap of $1.2 billion?
A. The plan as a whole is intended to reduce the funding gap.
Q. Is the goal to -- is the purpose of the plan to eliminate the funding gap of $1.2 billion?
A. It would be good if it did that, but the plan would not fail, in my opinion, if it failed to do that, no.
Q. So the reduction of the funding gap, through the plan, who is bearing the burden of that reduction?
A. If you describe the adjustments of the policies as bearing the burden, the policyholders would.
Q. Is there anyone other than the policyholders that's bearing the burden of those adjustments?
A. Putting aside tax considerations, probably not.
Q. So that's about 20,000 policyholders based on your testimony earlier in this cross?
A. No.
Q. No? How many policyholders?

A. Well, if you eliminate the non-forfeiture options, 30,000.
Q. And you don't further reduce it for the policyholders already paying the If Knew Premium?
A. I think we already talked about that. Those policyholders will have the ability to voluntarily select Options 2, 2A or 3.
Q. Okay. But you would agree, then, that the $1.2 billion would be addressed by the 30,000 long-term care policyholders?
A. The projected $1.2 billion funding gap would be addressed by them, yes.
Q. Exclusively?
A. No.
Q. Okay. Who else?
A. As I said, the taxpayers.
Q. The taxpayers?
A. Yes.
Q. Who?
A. To the extent that our plan is successful, we will eliminate potentially hundreds of millions of dollars in federal income tax liability. Doing that, I suppose,

arguably shifts that burden to other taxpayers.
Q. I don't pretend to be a tax expert, and yesterday I believe you testified that you weren't either, for which you deserve credit, but I'm going to just stick with the $1.2 billion, because I don't believe it's net of any kind of tax benefit; is it?
A. I think we're mixing apples and oranges.
Q. I do, too.
A. $1.2 billion is the projected deficit for the company.
Q. And the policyholders of SHIP, the 30,000 long-term care policyholders of SHIP are going to bear that through higher premium or reduced benefits; right?
A. If the entire deficit is eliminated under the plan, the answer is yes.
Q. Any portion of the deficit eliminated by the plan is being borne by the policyholders; isn't it?
A. Yes.
Q. Rather than spread to the guaranty fund system?
A. Correct.

Q. Now, you're a highly experienced specialist in insurance company receiverships. Do you understand or could you tell us why the life and health guaranty funds were created?
A. I do understand why they were created.
Q. Why were they created?
A. They were created in part because there was a concern that in the absence of a state-based mechanism for the protection of policyholders of failed insurers, there was going to be a shift from state to federal regulation of the insurance industry.
Q. So the exclusive purpose for creating the life and health guaranty funds was to avoid federal guaranty fund statutes?
A. I don't think so.
Q. Was there a policyholder protective purpose expressed with regard to the creation of a life and health guaranty fund?
A. Absolutely.
Q. Okay. Do guaranty funds spread the loss beyond the policyholders of an insolvent insurance company?
A. Yes.

Q. You have testified that they spread that loss in ways that are borne by taxpayers; is that correct?
A. In part, yes.
Q. In part. So one of the purposes of the life and health guaranty fund system is to spread the loss of an insolvency broadly so as not to concentrate it on the policyholders, exclusively the policyholders of the insolvent insurer; do you agree with?
A. I think that's one of the effects. I'm not sure whether that was the purpose.
Q. Does it have that effect? Does the triggering of the guaranty association spread the loss broadly across the United States?
A. I just said I think that is the effect, yes.
Q. And so why did the Rehabilitator of SHIP decide that it was better to impose the burden exclusively on the policyholders of SHIP?
A. As I explained yesterday, there were several factors. One is that the plan offers policyholders benefits that would not be available in liquidation.